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INFO AMEMBASSY THE HAGUE

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PASS CEA, TREASURY, FRB

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TAGS: OECD, ECON

SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE (EDRC)

REVIEW OF NETHERLANDS, JANUARY 13, 1976

REF: OECD DOCUMENT EDR(76)1

1. SUMMARY: IN A REFDOC CIRCULATED IN PREPARATION FOR EDRC REVIEW OF NETHERLANDS, SECRETARIAT FORECASTS ONLY MODERATE GROWTH IN 1976 DUTCH GDP (1.25 PERCENT), RISING UNEMPLOYMENT, AND INCREASES IN PRICES AT ONLY SLIGHTLY REDUCED RATE (8 PERCENT IN 1976 COMPARED WITH 10 PERCENT IN 1975). IN VIEW OF PROSPECTIVE DETERIORATION LABOR MARKET IN CIRCUMSTANCES OF LIKELY RISE IN CURRENT ACCOUNT SURPLUS (ATTRIBUTABLE IN LARGE PART TO INCREASED NATURAL GAS PRODUCTION) IN 1976, SECRETARIAT BELIEVES THAT GON HAS SUBSTANTIAL REASONS AND SCOPE FOR TAKING FURTHER STIMULATORY DEMAND MANAGEMENT MEASURES. MAJOR CONSTRAINT WOULD BE POSSIBILITY OF INDUCING EVEN GREATER INFLATIONARY

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PRESSURES, AND IN THIS RESPECT SECRETARIAT FEELS THAT

CENTRALIZED AGREEMENT UNDER GON AUSPICES ON WAGES AND INCOMES AND EFFECTIVE PRICE POLICIES WOULD BE ESSENTIAL TO COMBINE HIGHER GROWTH RATES WITH MORE MODEST RATES OF INFLATION. FOR MEDIUM TERM, SECRETARIAT SEES AS KEY PROBLEMS UNEMPLOYMENT AND GROWTH OF PUBLIC SECTOR TRANSFERS (INCLUDING INCREASED FINANCIAL BURDEN ON ENTERPRISES WHICH FINANCING OF SUCH TRANSFERS HAS ENTAILED). NOTING THAT RECENT INVESTMENT IN NETHERLANDS HAS TENDED TO BE FOR REPLACEMENT RATHER THAN EXPANSION OF EXISTING CAPITAL STOCK, SECRETARIAT CONCLUDES THAT MEASURES TO BOOST PUBLIC AND ESPECIALLY PRIVATE INVESTMENT ARE USEFUL. SECRETARIAT BELIEVES THAT NETHERLANDS "HAVING ONE OF THE STRONGEST BALANCE OF PAYMENTS POSITIONS AMONG MEMBER COUNTRIES, SHOULD NORMALLY PLAY A LEADING ROLE IN THE RE-EXPANSION OF ACTIVITY AND WORLD TRADE IN THE PRESENT PERIOD". ACTION REQUESTED: MISSION WOULD APPRECIATE RECEIVING FROM WASHINGTON AND AMEMBASSY THE HAGUE COMMENTS/ QUESTIONS WHICH COULD USEFULLY BE POSED IN EDRC REVIEW OF NETHERLANDS (IN WHICH REPRESENTATIVE FROM AMEMBASSY THE HAGUE WILL PARTICIPATE).

2. SHORT-TERM PROSPECTS. DOMESTIC SITUATION: SECRETARIAT ESTIMATES DUTCH REAL GDP DECLINED BY 2 PERCENT IN 1975 WITH INCREASE IN GOVERNMENT CONSUMPTION (4.5 PERCENT) AND IN PRIVATE CONSUMPTION (2.5 PERCENT) MORE THAN OFFSET BY THE 6.5 PERCENT FALL IN FIXED INVESTMENT AND BY STRONG INVENTORY DECUMULATION (2.5 PERCENT OF 1974 GDP). FOR 1976, SECRETARIAT FORECASTS INCREASE OF ONLY 1.25 PERCENT IN GDP. BUSINESS FIXED INVESTMENT IS EXPECTED TO DECLINE BY 7 PERCENT IN FACE OF FALLING PROFITS (BECAUSE OF RISING UNIT LABOR COSTS AND PRICE CONTROLS), SUBSTANTIAL EXCESS CAPACITY, AND POSSIBLE ADVERSE EFFECTS OF SELECTIVE INVESTMENTS REGULATIONS ACT (DESIGNED TO SHIFT INVESTMENT AWAY FROM CONGESTED WESTERN REGIONS). INCREASE IN GOVERNMENT INVESTMENT SPENDING SHOULD HOLD TOTAL DECLINE IN FIXED INVESTMENT TO ABOUT 4.5 PERCENT. SECRETARIAT FORECASTS PRIVATE 1976 CONSUMPTION INCREASE OF ONLY 1.5 PERCENT, MINIMAL STOCK LIMITED OFFICIAL USE

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FORMATION (0.75 PERCENT AND POSITIVE CONTRIBUTION OF 0.5 PERCENT TO GROWTH OF GDP FROM FURTHER IMPROVEMENT IN THE REAL FOREIGN BALANCE.

3. EMPLOYMENT: SECRETARIAT ESTIMATES THAT BY END OF 1975 THE UNEMPLOYMENT RATE IN THE NETHERLANDS WILL HAVE REACHED 5 PERCENT - TWICE THE 1973 LEVEL. MOREOVER, SINCE GON HAS TAKEN MEASURES TO LOWER LABOR PARTICIPA-

TION RATES, THE SECRETARIAT FEELS THAT EVEN 5 PERCENT FIGURE UNDERSTATES THE MAGNITUDE OF THE DETERIORATION IN THE LABOR MARKET. SLOW RECOVERY FORECAST FOR 1976 WOULD BE INSUFFICIENT TO REVERSE SITUATION IN LABOR MARKET, AND SECRETARIAT EXPECTS UNEMPLOYMENT RATE TO REACH 6 PERCENT BY YEAR-END.

4. WAGES AND PRICES: DESPITE DEPTH OF RECESSION, CONSUMER PRICE RISES IN 1975 WERE SUBSTANTIAL, REGISTERING, ACCORDING TO SECRETARIAT ESTIMATES, AN AVERAGE INCREASE OF 10.25 PERCENT OVER 1974. SECRETARIAT ATTRIBUTES STRONG UPWARD MOVEMENT (AND ACCELERATION) OF PRICES IN 1975 TO FACT THAT WAGE INCREASES DURING 1974 (16.5 PERCENT) HAD BEEN PARTIALLY BOTTLED UP BY PASS-THROUGH LIMITATIONS OF SPECIAL POWERS ACT, WHICH EXPIRED EARLY IN 1975, ALLOWING RAPID CATCH-UP OF PRICES. NEVERTHELESS, OECD NOTES THAT A CONSIDERABLE PORTION OF COST INCREASES WAS ABSORBED IN PROFIT MARGINS AND THAT OUTSTANDING FEATURE OF NETHERLANDS WAGE SITUATION (IN CONTRAST WITH EXPERIENCE OF MOST OECD COUNTRIES) IS TENDENCY OF WAGE RATES AND HOURLY EARNING TO RISE FASTER THAN PRICES. TAKING ACCOUNT TO EFFECT IN 1976 OF GON STATUTORY LIMITS ON WAGE INCREASES (ASSUMPTION IS THAT SIMPLE WAGE INDEXATION OF PRICES WILL FOLLOW EXPIRATION OF WAGE CONTROLS ON JUNE 30, 1976) AND COST PASSTHROUGHS, SECRETARIAT FORECASTS 8 PERCENT INCREASE IN AVERAGE EARNINGS AND EQUIVALENT INCREASE IN PRICES IN

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1976.

5. BALANCE OF PAYMENTS: COMBINATION OF WEAK DOMESTIC (AND IMPORT) DEMAND AND FORESEEABLE COMPOSITION OF DUTCH EXPORTS WAS LARGELY RESPONSIBLE FOR STRONG 1975 CURRENT ACCOUNT POSITION. SECRETARIAT ESTIMATES THAT IMPORT VOLUMES FELL BY 13.5 PERCENT IN 1975 WHILE EXPORT VOLUMES FELL BY ONLY 8 PERCENT. THESE EFFECTS WERE REINFORCED BY IMPROVEMENT IN TERMS OF TRADE LARGELY DUE TO INCREASE IN NATURAL GAS EXPORT PRICES. SECRETARIAT ESTIMATES TRADE SURPLUS MAY HAVE REACHED 2 BILLION GUILDER IN 1975 COMPARED WITH 0.4 BILLION IN 1974. SECRETARIAT FORECASTS 3.75 PERCENT INCREASE IN EXPORT VOLUMES IN 1976 WHICH, COMBINED WITH EXPECTED INCREASE IN IMPORT VOLUMES OF 3 PERCENT (WITH INCREASED NATURAL GAS PRODUCTION ACTING BOTH TO INCREASE EXPORTS AND TO REDUCE ENERGY IMPORTS), AND SOME RECOVERY IN INVISIBLES EARNING COULD LEAD TO WIDENING OF CURRENT ACCOUNT SURPLUS OF \$2.2 BILLION IN 1976 FROM \$1.75 IN 1975.

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6. FISCAL POLICY: POLICY TURNED EXPANSIVE IN 1975, AND SECRETARIAT ESTIMATES THAT COMBINED EFFECT OF PARTIAL INDEXATION OF TAX SCALES, OTHER MEASURES TO STIMULATE INVESTMENT AND EMPLOYMENT, AND ACTION OF AUTOMATIC

STABILIZERS LED TO BUDGETARY DEFICIT OF 2.25 PERCENT OF GDP, AND LEVEL WHICH WAS STILL INSUFFICIENT TO HALT DETERIORATION IN LABOR MARKET. SECRETARIAT FORECASTS INCREASE IN 1976 DEFICIT TO 2.5 PERCENT OF 1975 GDP, BUT TAKING SECTORAL FINANCIAL BALANCE APPROACH TO GOVERNMENT IMPACT, SECRETARIAT NOTES THAT INCREASE IN GOVERNMENT DEFICIT WILL BE INSUFFICIENT TO COUNTER-BALANCE INCREASED FINANCIAL SURPLUS OF PRIVATE SECTOR. GOVERNMENT CONSUMPTION IS EXPECTED TO SLOW DOWN CONSIDERABLY IN 1976, WHILE GOVERNMENT FIXED INVESTMENT SHOULD RISE BY ABOUT 4 PERCENT.

7. MONETARY POLICY IN RECENT YEARS HAS BEEN LARGELY GEARED TO EXTERNAL CONSIDERATIONS. THUS, IN LIGHT OF INTERNATIONAL INTEREST RATE CONDITIONS, THE DECLINE IN DUTCH INTER-

EST RATES BEGAN ONLY AT THE END OF 1974 -- LATER THAN SECRETARIAT FEELS WOULD HAVE BEEN APPROPRIATE IN LIGHT OF WEAKENING DOMESTIC SITUATION. HOWEVER, RELAXATION OF MONETARY POLICY DURING 1975 HAS HAD LITTLE EFFECT DUE TO WEAK PRIVATE DEMAND FOR CREDIT.

8. MEDIUM TERM: SECRETARIAT PINPOINTS UNEMPLOYMENT AND EXPANSION OF GOVERNMENT TRANSFERS AS CENTRAL MEDIUM-TERM PROBLEMS. NOTING THAT INVESTMENT IN RECENT YEARS HAS BEEN OF CAPITAL DEEPENING NATURE (REPLACEMENT RATHER THAN EXPANSION), SECRETARIAT CONCLUDES THAT HIGHER INVESTMENT TO BRING ABOUT MORE RAPID GROWTH RATES WILL BE NECESSARY IN FUTURE TO MAINTAIN EMPLOYMENT LEVELS. IN ADDITION, GROWTH OF PUBLIC TRANSFERS HAS LED TO HIGHER SOCIAL SECURITY CONTRIBUTIONS BY ENTERPRISES, CONTRIBUTING TO PRESSURES ON PRICES AND ON FINANCIAL POSITION OF FIRMS.

9. BASED ON REFDOC ANALYSIS, SECRETARIAT SUGGESTS THAT EDRC AGREE ON FOLLOWING MAIN CONCLUSIONS:
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-- BASED ON DESIRABILITY OF REDUCING UNEMPLOYMENT, STRONG REFLATIONARY ACTION (PARTICULARLY TO STIMULATE INVESTMENT) IS REQUIRED, BUT SCOPE OF DEMAND MANAGEMENT POLICY IS REDUCED BY RISK OF CONTINUING RAPID INFLATION;

-- WHEN STATUTORY WAGE AND PRICE REGULATIONS EXPIRE IN MID-1976, EVERY EFFORT SHOULD BE MADE TO ARRIVE AT A CENTRAL AGREEMENT UNDER GON AUSPICES ON WAGES AND INCOMES TO ESTABLISH LASTING BASIS FOR NON-INFLATIONARY GROWTH OF OUTPUT AND EMPLOYMENT;

-- FOR MEDIUM TERM, A REDUCTION IN SOCIAL SECURITY

CONTRIBUTIONS OF FIRMS WOULD BE APPROPRIATE. MOREOVER, THERE IS A GENERAL NEED TO REVIEW MEDIUM-TERM TRENDS IN PUBLIC FINANCE WITH RECEIPTS NOW ACCRUING TO THE GOVERNMENT FROM NATURAL GAS PRODUCTION GREATLY FACILITATING DESIRABLE ADJUSTMENT.

10. COMMENTS: (1) IF, AS IN PAST, DUTCH MONETARY POLICY REMAINS GEARED TO INTERNATIONAL MONETARY DEVELOPMENTS, DUTCH INTEREST RATES COULD RISE DURING 1976 AS RECOVERY IN MAJOR OECD COUNTRIES INCREASES PRESSURE ON CAPITAL MARKETS. SINCE NETHERLANDS IS APPARENTLY LAG-

GING IN RECESSION/RECOVERY CYCLE AND IN VIEW STRONG
CURRENT ACCOUNT POSITION, MISSION PLANS TO ASK DUTCH
WHAT MEASURES ARE PLANNED TO OFFSET ADVERSE EFFECTS ON
INVESTMENT OF INCREASED INTEREST RATES. (2) MISSION
ALSO PLANS TO ASK TO WHAT EXTENT CHANGES IN RELATIVE
PRICES (ESPECIALLY OIL) MAY HAVE ACCELERATED TENDENCY
FOR INVESTMENT TO BE CAPITAL DEEPENING.
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